

CHAPTER 9

INTERNAL CONTROLS

0901 PURPOSE. This chapter prescribes the internal control techniques that are to be designed and implemented into all DoD NAF accounting systems.

0902 REQUIREMENTS

090201 Legal. 31 USC 3512 requires the head of each executive agency to establish and maintain systems of accounting and internal control that conform to the requirements prescribed by the Comptroller General of the United States. The head of each executive agency is required to report annually on whether the agency's accounting systems conform to the accounting principles, standards, and related requirements prescribed by the Comptroller General. The accounting requirements of the Comptroller General prescribed under section 3511 are set forth in the General Accounting Office Policy and Procedures Manual for Guidance of General Agencies and implemented in this regulation.

090202 Internal Controls - The plan of organization and all of the coordinate methods and measures adopted within a business entity or activity to safeguard its assets, check the accuracy and reliability of its accounting data, promote operational efficiency, and encourage adherence to prescribed managerial policies. Accounting controls for safeguarding assets and ensuring the reliability of records include systems of authorization and approval, separation of duties, physical controls over assets, and internal auditing. Administrative controls concerning operational efficiency and compliance with policies and procedures include statistical analyses, training programs, and quality controls.

090203 Systems. Subsection (a) of section 3512 requires the head of each executive agency (including the DoD Components) to have systems of accounting and internal control which

provide:

A. Complete disclosure of the financial results of agency activities;

B. Adequate financial information needed for agency management purposes;

C. Effective control over, and accountability for, assets for which the agency is responsible;

D. Reliable accounting results and reports that will be the basis for preparing and supporting agency budget requests, controlling budget execution, and providing financial information the President requires, and;

E. Suitable integration of agency accounting with Treasury's central accounting and reporting responsibilities.

0903 INTERNAL CONTROL STANDARDS. The standards contained in this chapter apply to all manual and/or automated systems of accounting and related internal controls under development, under major revision, or currently operating in all DoD Components. These standards, along with other applicable requirements, shall be considered when Component heads report annually in compliance with management control standards prescribed by GAO and guidelines issued by OMB as they relate to their accounting systems as required by the Federal Manager's Financial Integrity Act, P.L. 97-255. The internal management control (IMC) program is implemented by DFAS 5010.38-R.

090301 Structure of the Accounting System

A. The accounting system shall be structured to produce and report financial information to satisfy the internal needs of the DoD Component and the external reporting

needs of the executive branch, the Congress, and the public as applicable.

B. The system shall be structured in such a way that it ensures the proper gathering, recording, storing, processing, communication, and consistent reporting of the information.

C. Information shall be organized by project or program, responsibility centers, activities, object class of expenditure, organization units, appropriation, etc.

D. The system shall be flexible so it can adapt to changing user and external requirements during the system's life cycle.

E. The system shall be flexible enough to handle additions or deletions, including changes to accounts or account codes, classifications, organizations, and dollar thresholds, without extensive program or system changes.

F. Data shall be captured at the lowest level of detail to facilitate adapting to new and expanded report requirements.

G. The accounting structure shall provide for general ledger and subsidiary accounts, incorporating the double-entry concept.

H. The account structure within the general ledger shall be driven by the type of funds involved and the nature of the Component's operations.

I. The general ledger account structure shall support required internal and external reporting and shall conform with the general ledger as prescribed in the appropriate appendix contained in this regulation.

J. The accounting system shall provide a means of capturing and reporting transactions by organizational segments, appropriations and funds, budget activities, programs, projects, geographic locations, obligations, disbursements, objects of

expenditures, etc. as necessary to meet user needs and outside reporting requirements and inquiries.

K. The classification coding scheme shall be coded in such a way that lower levels of data roll up into higher levels. For example, projects normally roll up into programs, which roll up into budget activities, which roll up into appropriations, which roll up into Component-level information, which roll up into consolidated department wide information.

L. Programming, budgeting, accounting, and reporting classifications shall be consistent with each other and synchronized with the organizational structure so that actual activity can be compared with enacted budgets and support future budget formulation for each management function. To achieve this consistency and synchronization, the account structure and transaction coding and data classification scheme shall be uniform or translatable among all accounting, budgeting, and reporting systems and subsystems, within the Component.

090302 Accounting Processes and Procedures

A. Support for Transactions

1. The financial transactions for which the accounting system must account shall be adequately supported with pertinent documents and source records.

2. These transactions, and any subsequent adjustments, shall be authorized and executed in accordance with management criteria by personnel acting within the scope of their authority.

3. Transactions shall be properly accumulated and correctly classified, coded, and recorded in all affected accounts.

4. Transactions shall be recorded in the accounts promptly and accurately, in the proper amount, to permit preparation of financial reports in accordance with internal needs and external requirements

and prompt analysis of the information by management.

5. Information shall be captured in the accounting records simultaneously with or immediately following the economic event that gave rise to the transaction.

6. All transactions, including those which are computer-generated and computer-processed, shall be uniquely referenced to individual source records.

7. Referencing shall be done in a manner that enables tracing or replicating a transaction from its source to the resulting record or report, and from the resulting record or report to the source, or by tracing indirectly to source records through summaries and calculations contained in general and specific journals.

8. Individual source records fall into the following three categories:

a. Documents (either traditional source documents or paper documents or forms created when data are entered at a terminal),

b. Source listings of transaction data entered at a terminal (these listings include the same data elements as the traditional source document without generating the individual documents), and

c. Source records stored on magnetic media such as disk or tape.

9. Items in source records necessary for audit trail purposes shall include transaction type, record or account involved, amount, processing references, and identification of the preparer and approver of the transaction.

10. To facilitate tracing to source documents, the ledger account shall include transaction references, that is, a record of all postings to the account.

11. In the case of computer generated transactions, verification shall be accomplished through reviews of systems documentation such as edit routines, decision criteria in program listings, master files or data base records, detailed listings of computer media work files, or input transactions which trigger other computer generated transactions.

12. Electronic certification procedures shall include software lockouts to prevent unauthorized individuals from modifying or accessing any information not within the scope of their authority.

B. Reconciliation

1. General ledger balances shall be reconciled with subsidiary accounts and records, either manually or by the computer, in a timely manner.

2. Regularly scheduled reconciliation of control and subsidiary accounts and records for such things as cash receipts, accounts receivable, inventories, and accounts payable shall be performed to substantiate and maintain the accuracy of account postings and balances by checking the agreement between the sum of the detail in subsidiary accounts with the general ledger control balances.

3. General ledger property control accounts shall be periodically reconciled to detailed property records.

4. Accounting records shall be adjusted to be in agreement with the results of physical inventories when they are taken.

5. The results of periodic physical counts of cash and cash items shall be reconciled to recorded amounts and any discrepancies adjusted.

6. Financial data produced by program offices or other financial systems shall be reconcilable with the comparable data in the accounting system.

7. The system, whether

automated or manual, shall have the capability of readily reconciling expenditure data with obligations and outlay data.

8. The system shall include appropriate procedures for closing the accounts at the end of one accounting period and reopening accounts at the beginning of the next period.

C. Transaction Processing/ Production Control

1. The accounting system shall contain internal controls which operate to prevent, detect, and correct errors and irregularities which may occur anywhere in the chain of events from transaction authorization to issuance of reports.

2. The controls shall cover the functions of transaction authorization and approval, data preparation and validation, input, communications, processing, storage, and output, as well as error resolution and reentry and file or data base quality maintenance.

3. The internal controls shall provide reasonable assurance that the recording, processing, and reporting of financial data are promptly performed and that the completeness and accuracy of authorized transactions and data are ensured during automated (or manual) processing of the accounting.

4. Input controls shall exist to detect incomplete, duplicate, or otherwise erroneous transactions and ensure they are controlled until corrected.

5. Processing controls shall exist to provide reasonable assurance that all transactions have been processed and that the application processing was correct, using correct file data, operator procedures, and processing logic.

6. Output controls shall provide reasonable assurance that the output is complete, correct, and distributed only to authorized users.

7. Data communication controls shall exist to ensure that the integrity and confidentiality of messages (data) transmitted by communication lines from the originating point to the reception point are maintained.

8. Data storage and retrieval controls shall exist to ensure that the files and data are protected from loss, destruction, and unauthorized changes, and that only the correct and latest version of data and program files are used during processing.

9. While the particular procedures and records used to effect these controls are left to each Component, the accounting system shall include controls, where appropriate, that prevent or detect the following kinds of situations:

- a. Failure to record a transaction,
- b. I n c o r r e c t o r incomplete recording of a transaction,
- c. Duplicate recording of a transaction,
- d. Loss of a transaction document in handling,
- e. Incorrect entry of data at a terminal,
- f. P r o c e s s i n g o f unauthorized or incorrect data,
- g. Directly changing account/master file/data base records without an authorized transaction,
- h. Use of a superseded or test version of a program rather than the current production version,
- i. Use of a wrong file or record in processing,
- j. Unauthorized file

maintenance transaction (which have a financial impact),

k. Use of an incorrect value in internal tables,

l. Incorrect default value,

m. Input of incorrect program parameters,

n. Unauthorized use of programs which bypass normal program controls and edits,

o. Incorrect or incomplete processing logic,

p. Abnormal interruption of the application processing run,

q. Destruction of part or all of a file during processing,

r. Data base errors,

s. Inappropriate use of operating program testing aids to circumvent normal processing control procedures,

t. Out-of-balance conditions, and

u. Data errors caused during data transfer between interfacing systems.

10. The accounting system shall provide a reference and control list of transactions processed during a processing cycle or a given period of time.

D. Error Handling

1. The accounting system shall provide procedures for control over errors to ensure that once errors are detected:

a. Corrections are made in a timely manner and reentered into the appropriate processing cycle,

b. Corrections are made only once, and

c. The correction itself is validated.

2. Data items that contain errors shall be carefully controlled to ensure they are resubmitted (i.e., the transaction is not lost).

3. For data input errors, error lists or reports indicating why each item was rejected shall be prepared and open items shall be tracked and aged until all errors are corrected.

4. The system shall provide management with reports that list errors, reasons for errors, and corrective action taken.

5. Supervisor personnel shall review error listings and corrections.

6. Procedures shall be established for periodically analyzing reasons for errors and rejected transactions by type and source so that appropriate actions may be taken to obtain improvements.

7. When transaction are input through a terminal, either on-line or for later update to the system, the transaction and its data elements shall be edited as keyed, errors found by the edits are resolved and re-input by the person keying the transaction, or the transaction is held in some fashion until all the data are validated.

8. When error resolution cannot be done at the terminal, the document or source record shall be controlled to ensure errors are researched, corrected, documented, and resubmitted for input into the system in the appropriate processing cycle.

9. Additional editing by the application software shall occur once the transaction is in the system.

E. Control Over Output

1. Output distribution shall be controlled to ensure that only properly authorized personnel receive reports or other output.

2. Prior to distribution, outputs shall be checked for such things as completeness, agreement of control totals, and appropriateness of the number of copies.

3. If feasible, a cross-check with output from related programs shall be done.

4. The user group or area responsible for the function related to the output shall perform simple error detection and control procedures (e.g. visual scans, tests against independently maintained control totals, comparison with approximations or physical counts) before relying on the output.

F. Verifying File Data

1. Since data quality can deteriorate over time the accounting system shall provide maintenance procedures to ensure the continuing quality of files.

2. Depending on what the application and record type are, file reviews shall be performed by the users or other personnel who would be most effective in detecting discrepancies.

3. The need for periodic special reviews to verify file data shall be reduced where input controls are effective and when the examination of reports routinely produced by the system can be relied upon to serve this purpose.

4. Component management shall determine the frequency and extent of file quality reviews with due regard to the risks and costs involved. Similar review procedures shall be considered for satellite files (stored tables) used by application programs.

G. Reviews and Evaluations of the System in Operation

1. Periodic reviews and tests of the accounting system shall be performed to ensure that the system and its controls and security features continue to meet user needs, perform as intended, and conform with applicable accounting standards.

2. In certifying compliance with prescribed accounting principles, standards and related requirements as required by the Federal Managers' Financial Integrity Act, transaction testing of the system in operation shall be performed.

3. Transaction testing shall be done on the critical aspects of the system and results are documented.

4. Tests shall be designed to disclose whether valid transaction are processed properly and whether the system rejects invalid transactions.

5. The tests shall cover the entire flow of transactions from initial authorization through processing, posting to the accounts, and reporting.

6. In developing test plans, consideration shall be given to the results of any prior system testing.

7. When the system involves manual operations, interview and observation techniques shall be performed because of the higher risk that prescribed accounting procedures or control techniques are not consistently followed or that the results of processing test transactions are not representative.

8. System evaluation policies shall provide for more comprehensive evaluation on a cyclical basis. For example, independent and fairly detailed reviews of the entire system or of a major portion of the system might be made every third year, with personnel who operate the system performing less comprehensive reviews in the interim.

9. More than one of the

following testing techniques shall be used to test all key aspects of an accounting system:

- a. Interviewing persons who operate the system.
- b. Observing operating procedures.
- c. Examining system documentation.
- d. Independently verifying data integrity by use of generalized audit software.
- e. Verifying that the computer-based system correctly processes (or rejects) both valid and invalid transactions by using actual or simulated transactions.
- f. Reviewing process and error reports and evaluating error follow-up procedures.
- g. Comparing data from related reports and records.

10. Accounting System managers shall:

- a. Promptly evaluate findings and recommendations made by auditors and others reviewing accounting systems.
- b. Determine proper actions in response to findings and recommendations.
- c. Complete, within established time frames, all actions to correct or resolve findings and recommendations.

H. Financial Reporting

1. Financial reports shall provide information users need, be easy to understand, be accurately and promptly prepared on a consistent and comparable basis, fairly present information and relevant disclosure data, and include the effect of all and

only transactions of the period being reported upon.

2. Financial reports shall comply with restrictions on information classified for security purposes.

3. Internal and external reports shall be prepared from the same source data (the underlying accounting records or data base) and shall be in agreement.

4. Reporting periods may vary between systems; therefore, reconciliation is required between systems.

5. Except when estimates are clearly appropriate, information included in external reports required by the Treasury and OMB shall be from the general ledger or accounts under general ledger control.

6. Interagency, intra-agency, and interfund transactions shall be separately identified in records and statements so they can be properly treated in preparing consolidated reports.

7. Financial statements shall be prepared based on the entity's systematic accounting process covering the total operations of the reporting entity.

I. Accuracy

1. All financial data presented in reports shall be accurate.

2. Reasonable estimates shall be clearly identified in reports and statements when precise measurements are impractical, uneconomical, unnecessary or would cause delay in report issuance.

3. If financial data or reports are based on sources other than the official accounting system, their basis shall be clearly explained.

4. The component's financial reports shall include full and adequate disclosure

of financial and accounting information, including:

a. Disclosure of related party transactions.

b. Liability for employer benefit plan.

c. Department of the Treasury specific reporting requirements.

5. Automated and manual controls built into the system shall ensure the accuracy of financial data collected, processed, and reported. In addition, when reports are manually prepared, they shall result directly from financial data coming from the system and shall be prepared by designated individuals knowledgeable of the reporting requirements, and reviewed and approved by supervisory personnel.

J. Usefulness

1. Internal reports, including reports presented on terminal screen displays, shall be designed and produced to meet users' needs.

2. Recurring internal financial reports shall be based on explicit statements of financial information requirements for each user organizational unit.

3. Information needed by users shall be identified when designing the system.

4. Reports and user satisfaction with the level of detail, frequency, and report distribution shall be verified periodically.

5. Written policies and procedures shall be developed for initiating and approving requests for financial information and for changes to report formats.

6. The accounting system ad hoc reporting or query capabilities, as well as

agency procedures for using these capabilities, shall be readily available to system users.

7. All internal reporting policies and practices shall be reviewed periodically to determine their continued usefulness and whether they represent organizational and program changes.

8. The responsibility for keeping current on changing requirements of external reports shall be assigned to a particular individual or group.

9. Reports shall be designed to highlight major problems, exceptions, or trends and to facilitate the monitoring and evaluation of operations.

10. Reports produced by the accounting system shall compare current and prior-period performance, and planned performance with actual performance in a variety of ways, including on a cash, accrual, or obligation-basis.

11. Reports shall be designed so they can:

a. Signal when controls over funds or other resources have broken down.

b. Alert managers when operations are deviating from financial plans.

c. Provide the financial data needed to analyze and predict the financial consequences of alternative course of action.

12. Accounting system reports, combined with other management information, shall provide managers with a wide range of useful reports that contrast anticipated work units and their anticipated costs with actual work units and actual incurred costs.

13. Data shall be saved as appropriate for historical as well as for reconstruction of data files.

K. Timeliness

1. Reports shall be promptly produced to be of maximum use to management and to meet external requirements.

2. When timeliness is particularly critical, reporting needs shall be met by providing the capability to query the system's data base or by ad hoc report generation capabilities.

3. Systems shall have back-up and recovery provisions to help ensure timely report generation in cases of processing interruption or emergency situations.

4. The Component shall develop and maintain reporting schedules and due dates.

5. Responsibility for report distribution shall be assigned to one individual or group.

6. A control list of reports produced, their due dates, and authorized recipients shall be maintained and checked off as reports are issued.

7. Approved cut off dates shall be established for data input for produced reports and this shall be communicated throughout the Component.

8. Financial reports shall be issued periodically according to the accounting period and as needed.

L. Consistency

1. Financial management data shall be recorded and reported in the same manner throughout the Component using standard accounting and budget definitions and classifications.

2. Financial data reported shall be derived from general ledger accounts that are maintained on a consistent basis from period to period.

3. Any material changes in

accounting policies or methods and their effects shall be clearly explained in the reports.

M. Operation, Maintenance, and Evaluation

1. Management shall monitor an operating accounting system's life cycle to ensure that the system's stability is maintained because of changes in hardware and software.

2. Successful application of management policies and procedures for controlling changes in system software and hardware and improved compilers, and the proper training of new employees shall operate to protect against communication problems, data entry failures, and user negligence.

3. Well-defined organizational responsibilities and strict adherence to procedures and controls governing the processing of changes to the system, such as system maintenance, shall operate to ensure stability of the system in operation.

4. All system changes shall be properly authorized in writing and such authorizations shall be maintained with the system documentation.

5. The separation of duties required for control purposes shall include to the extent practical the following:

a. Computer operations group: Has responsibility to deliver to users products generated by the application systems, to assess problems, and to act as a liaison between users and the maintenance support group in resolving problems.

b. Maintenance support group: Has responsibility to accomplish and document changes or enhancements to meet user needs or to correct program errors detected within the group.

(1) Care shall be used, through use of formally approved and documented system change control procedures,

to protect against fraudulent or otherwise unauthorized changes to previously tested and accepted application systems and data bases.

(2) C o n t r o l procedures shall require proper analysis of requested changes.

(3) After the analysis is completed and documented, user and/or ADP management shall approve the changes before modifications are made.

(4) Within the maintenance support group, not all programmers shall have access to all application software.

(5) After any changes are made, the maintenance support group shall conduct appropriate tests and reruns of the application software to ensure that procedures and controls are working as intended.

c. User groups: Are responsible for ensuring, to the extent practicable, the integrity of data input, processing, and output. This responsibility includes making sure that internal controls and operating procedures are properly implemented, training and operating manuals are provided to appropriate personnel, operations are continually evaluated against the design requirements, problems are promptly communicated, and errors are promptly resolved. In addition, key duties in authorizing, processing, recording, and reviewing transactions shall be separated among individuals.

N. System Documentation

1. The system documentation shall be complete, current, and maintainable.

2. The documentation shall be of sufficient scope and depth to provide management, users, auditors, and system operation, maintenance, and modification personnel with an understanding of the design and operation of each component in the system and its integration with and relation to all other

components.

3. Documentation of the operating system shall be appropriately safeguarded and periodically updated so that it always shows actual operations.

4. System documentation shall include the requirements specified in chapter 2 of Volume 1 of this regulation.

5. Internal control objectives and techniques, pertinent aspects of transactions, and other significant events shall be documented.

a. Internal control objectives shall be logical, applicable, and complete.

b. Internal control techniques shall be effective and efficient in accomplishing the applicable objectives.

6. System documentation shall be available and easily accessible for examination.

O. Personnel

1. Accounting operations shall receive high priority by ensuring that each AO is supervised by a qualified, professional accountant.

2. Accountants shall be aware of, and adhere to, all prescribed accounting principles, standards, and related requirements.

3. All personnel in the operating AO shall receive adequate training to efficiently and economically accomplish their assigned responsibilities.